THE ADMINISTRATION AND CONTROL OF THE PROPOSED CENTRAL RESERVE ASSOCIATION[1]

The question of the control of the Central Reserve Association seems destined to play the leading rôle in the popular discussion of the subject. The average man genuinely fears the influence of Wall Street, "the interests," and politics, and will pay little attention to any feature of any plan proposed other than that of control until he is satisfied that it properly provides for the elimination of the domination of such influences. His instincts in this matter, as in others, are correct. Popular control of an institution so vitally associated with the economic welfare of every citizen, as a central reserve association would be, is essential. The Aldrich plan has been criticized from this point of view, and we may properly approach the subject through an examination of that criticism.

The Aldrich plan places the control in the hands of the banks which compose the local associations, a majority of such banks determining by their votes the composition of three-fifths of each directorate of each local association, and directly and indirectly of a majority of each directorate of each branch and of the central association at Washington. If any interest or combination of interests gets control, therefore, it will be by influencing a sufficient number of banks in these local associations to turn the balance of power in their favor. The question is, will that result be possible, and if so, how? Mr. Hill answers by creating $25,000-banks in such numbers as may be necessary.

It must be confessed that in its present form the Aldrich plan renders that criticism possible because it leaves open so many of the necessary details involved in the organization of the local associations. It provides simply that the minimum capital shall be $5,000,000, and the minimum number of banks ten. On what principle the subscribing banks shall be grouped it does not specify. Is it not at least conceivable, it may be asked, that the association districts might be so gerrymandered that the creation of a compara-

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tively small number of new banks at the right points would throw the balance of power into the hands of the interests back of the new creations? This question must be answered before the value of Mr. Hill's criticism can be estimated.

The influence of Wall Street and "the interests" is chiefly exerted through control of banks and big business corporations which center in New York City. Since these concerns transact business of national scope, including that of the great railroad systems and the trusts, all parts of the country come under this influence to a greater or less degree. Its various ramifications are difficult to trace, but it is safe to assume that its magnitude diminishes roughly as the distance from New York increases, and that it is greatest in the large cities and least in the country towns. The extent of this influence at any point it is impossible to determine, and hence the accuracy of any estimate is sure to be questioned by extremists. I believe, however, that no one who is not an extremist, and who weighs the pertinent evidence fairly, would estimate it to be sufficiently great to control the votes of a majority of the banks in the country towns and moderate-sized cities of the country and in many of the large cities. In some of the latter such control is highly probable, although on this point opinions will doubtless differ.

In estimating the magnitude of this influence it must be remembered that the control of the *votes* of bank directors is a very different matter from the control of many of the conditions under which they are obliged to do business. That a comparatively small group of Wall Street financiers exercises a large measure of control over money-market conditions throughout the country at the present time, is a widespread belief and is supported by a formidable mass of evidence; but that such control is desired by a majority of the bankers of even our large cities is not supported by the same evidence. On the contrary, the records of the proceedings of local bankers' associations, the local financial papers, and the published and spoken utterances of bankers in every part of the country furnish a mass of evidence in support of the proposition that they are very restive under Wall Street control, and are eagerly in search of ways and means of escaping it. That coercive measures other-

wise efficient would lose much of their power when the proposed National Reserve Association is in question is evident from the fact that this association opens the very road of escape of which they are in search.

Even if it be assumed that the interests of the big city bankers are identical with those of Wall Street—a proposition which in my opinion cannot be successfully maintained—the same assumption cannot be made regarding the country banker and the banker in the small or moderate-sized city. His interests are in entire harmony with those of the local business men of his section, and in this age of progressiveness in politics, and in the midst of the evidences on every hand of a national uprising against the domination of Wall Street and "the interests" in the affairs of the nation, there can be no reasonable question regarding the way he would vote on the question of Wall Street control of the National Reserve Association.

I believe, therefore, that we may safely proceed in the discussion of this question on the assumption that if the bankers of the country as a whole are given the right to elect the governing bodies of the National Reserve Association, those at least outside of the large cities and many of those within will vote every time against the Wall Street candidates, whether they are voting by the "one bank one vote" method or according to the number of shares of stock they own in the association. The question is: Under the Aldrich plan can they be outvoted by the Wall Street interests and their allies in the large cities, either through the strength of the stock holdings in the association which those interests may purchase or through the creation of small banks?

According to the Aldrich plan the relative influence of the large city banks will depend chiefly on the composition and number of the local associations. They will have votes only in those associations to which they belong, and whether or not they can control them depends upon their number in comparison with the numbers of the outside banks included. If, therefore, the local associations in localities in which there are big cities are co-extensive with these cities, or if there is more than one such association in these cities, the big banks may control them and then select a corresponding number of directors of the branches to which they are attached. On

the other hand, if every local association, as it may be, is so constituted that a majority of its members are country or small town banks, the control of even a single association by the big city banks might be rendered impossible, in which case their influence in the election of branch directors would be correspondingly less.

The significance of the number of local associations in a district in which there are one or more large cities becomes evident when one considers such a case, for example, as the following: Suppose there are 500 banks in a given territory, say a state, in which there is a big city containing say 25 big banks, the capitalization of which is equal to that of all the other banks in the association combined. If the 25 city banks be organized into one local association and the other 475 banks into five, that territory will choose six directors of its branch on the "one bank one vote" basis and four on the basis of the number of shares of stock owned. On the former basis the big banks will choose one director and the others five and on the latter each group will choose two. Of the total number, ten, the country banks will elect seven and the big banks three.

Let us now change our assumption and suppose that the big city banks are organized into one association as before and the others into two instead of five. Three branch directors will now be chosen by this district on the "one bank one vote" basis and two on the basis of stock-ownership. The big banks will elect one on the former basis and the others two, and one each will be elected on the stock-ownership basis. In this case, of the total number, five, the big banks choose two and the others three. The big banks' percentage of directors in this case is 40 whereas in the former case it was 30. It would, of course, be easy so to arrange the grouping and the number of associations that the big banks would have a majority, and it would be equally easy so to arrange them that they would be in a hopeless minority.

At this point the query arises whether the number of big cities is sufficient and their distribution throughout the country such as to render possible a gerrymander which would place the control of the reserve association in their hands. According to the reports of the Census Bureau, in 1906 there were 42 cities in the United States having a population of 100,000 each or more. These were

distributed among 24 states, including the District of Columbia, of which 16 had one each, 2, two each, 3, three each, 2, four each, and 1, five. Five of these are in New England; 13 belong to the eastern group; 4 to the southern; 14 to the middle western; 2 to the western; and 4 to the Pacific. Twenty-six states and territories, including Alaska, are without such cities, and of these, 2 are in New England, 1 belongs to the eastern group, 9 to the southern, 1 to the middle western, 7 to the western, and 5 to the Pacific.

According to the report compiled for the National Monetary Commission by Assistant Secretary Andrew, there were in 1909 a total of 22,459 banks in these states, of which 1,800 were in New England, 2,715 in the eastern group, 5,143 in the southern, 7,709 in the middle western, 4,331 in the western, and 1,481 in the Pacific. For every city of 100,000 population or over, therefore, there are in New England approximately 216 banks, in the states of the eastern group 209, in those of the southern 1,286, in those of the middle western 550, in those of the western 2,165, and in those of the Pacific 370.

An attempt provisionally to construct local associations that would accommodate all the banks in even an approximately adequate manner reveals the fact that a big city, in the sense in which we are using that term, could not be included in each local association in all the states that have such cities. This result might be accomplished, perhaps, in a few of them, but it would be practically impossible in most. For example, with the possible exception of Rhode Island, Connecticut, and the District of Columbia, no state having only one big city within its borders could be expected to be accommodated by only one local association. Whether the guiding principle for the organization of such associations be the number of banks, their location with reference to each other, or their capitalization, some of these states would need several. Arbitrarily assuming that as a rule a local association ought not to contain more than 150 banks, the needs of these states would be about as follows: four of them would need 2 associations each, one 3; one 4; five 5 each; two 6 each; and one 8. Of the states having more than one large city each, on this same basis one would

need 3 associations; one 5; two 6 each; one 7, and one 8. Altogether those states containing the 42 large cities would need, according to this calculation, 102 local associations, and the maximum number of associations which the large city banks could control would be 42. If these 42 associations were so arranged as to contain each a majority of country banks, not all of their votes could be controlled by the big city institutions.

Applying the same principle of organization to the states without large cities results in a total of 72 associations for these, distributed as follows: 5 in New England; 1 in the eastern group; 27 in the southern; 8 in the middle western; 5 in the Pacific; and 1 in Alaska.

According to this calculation, then, the total of local associations for the entire country would be 174, of which the maximum number that could be controlled by the big city banks would be 42 or a little over 24 per cent. If the basis of calculation be changed so as to result in a larger total of associations for the entire country, this percentage would be smaller, and in the opposite case larger.

Whatever else it amounts to, this calculation reveals the significance of the question of the principle or principles which should serve as guides in the organization of local associations. In the search for these we must never lose sight of the functions of these associations, of which the primary one is the inspection and securing of the paper which its members may wish to have rediscounted at the branches or the central office. In order properly to perform this function, the officers of each association must become thoroughly familiar with the business of their territory, with the men and the concerns which are conducting it, and with the personnel and the methods of the banks under their supervision. And they must maintain this familiarity at all times by keeping constantly in touch with these matters. It is also important that the resources of the banks constituting any association should be large enough to make its guaranty good beyond question and to render light the burden on each bank in case of loss, ends the attainment of which are perhaps adequately secured by the provision in the Aldrich plan which fixes the minimum capital of an association at $5,000,000.

In order to secure the requisite closeness of contact between

the officers of an association and the banks and the business men with whom they must deal, it is obviously important that the extent of their territory should not be too wide nor the number of banks under their supervision too large. It would seem, therefore, that the number of banks, the density of population and the amount of business transacted should have most weight in the determination of the extent of territory to be covered by an association, and that the regulations regarding this matter to be incorporated in the law to be enacted should be calculated to encourage relatively small rather than large associations.

This view of the matter is also enforced by the fact that the closer the connection between the officers of a local association and the banks and business men in their district, the greater the possibility of using the association for other good purposes than that of passing upon and guaranteeing the paper submitted for discount. It is not impossible, I believe, that with time additional functions may develop, the importance of which to the banks and the country may transcend those specifically defined in the act; but the development of such functions will depend very largely on the closeness of the contact between the officers of an association and their district. These considerations seem therefore to lead in the same direction as those pertaining to control, and to suggest that the plan we adopt should provide for a relatively large number of local associations. In that event the influence of big banks will be minimized and the possibility of their control made more remote.

Turning now to the question of control of the branches we are confronted first of all by the problem of their location. The Aldrich plan provides simply that the country shall be divided into fifteen districts each of which shall be supplied with a branch. The only purpose to be served by such a system is the convenience of the banks; otherwise all the business would better be transacted at one office; and convenience in this case means easy access to the association's offices. In locating branches, therefore, transportation facilities, the distribution of banks, and the relative importance to banks of different regions of the amount of time required for the transaction of business with the association should be the primary considerations. A rough calculation on this basis seems to indicate

that New England should have one branch, the eastern states, one—the central office at Washington serving the more southerly of them as well as Virginia—the southern states, three, the middle western, four, the western states four, and the Pacific states, two.

Assuming such a distribution and employing the calculation regarding the number and distribution of local associations previously referred to, we arive at approximately the following results: The New England district would contain 10 local associations and 4 big cities; that of the eastern states 18 local associations and 12 big cities. Eight local associations and 2 big cities would belong to the district served by the central office at Washington. One of the southern districts would contain 14 local associations and 1 big city, another 13 locals and 2 big cities, and the third, 9 locals and no big city. Of the middle western districts, one would contain 12 locals and 6 big cities, one 20 locals and 4 big cities, the third 12 locals and 3 big cities, and the fourth 23 locals and 3 big cities. One of the western districts would have 9 locals and 1 big city; two others, 4 locals each and no big city; and the fourth 9 locals and no big city. Of the two Pacific coast branches, each would have 5 locals and 2 big cities.

According to the Aldrich plan the number of directors of each branch would be double the number of local associations in the district it served, of whom one-half would be chosen, one from each local association, two-thirds of the remainder by voting representatives, each casting a number of votes equal to the number of shares of stock in the association held by the banks in its district, and the other third by the directors thus chosen. Assuming for the sake of definiteness of expression that the New England branch will be located in Boston, that of the eastern states in New York, those of the southern states in Atlanta, New Orleans, and Fort Worth, those of the Middle West in Cincinnati, Chicago, St. Louis, and Minneapolis, those of the West in Denver, Salt Lake City, Helena, and Oklahoma City, and those of the Pacific in Seattle and San Francisco, and assuming further that the proportion between the capitalization of national banks in the big cities and those outside holds for all the banks and trust companies which it is proposed to admit to the association, we arrive at the following

results: The Boston branch would have 20 directors of whom 6 would be chosen by the big city banks and 14 by the others; the New York City branch would have 36 directors, of whom the big city banks would choose 26 and the others 10; the Atlanta branch, 28 directors, 2 chosen by the big city banks and 26 by the others; the New Orleans branch, 26 directors, 4 chosen by the big city banks and 22 by the others; the Fort Worth branch 18 directors, all chosen by banks outside of big cities; the Cincinnati branch, 24 directors, 9 chosen by the big city banks and 15 by the others; the Chicago branch, 40 directors, 10 chosen by the big city banks and 30 by the others; the St. Louis branch, 24 directors, 7 chosen by the big city banks and 17 by the others; the Minneapolis branch, 46 directors, 7 chosen by the big city banks and 39 by the others; the Denver branch, 18 directors, 2 chosen by the big city banks and 16 by the others; the Salt Lake City and Helena branches would each have 8 directors all chosen by banks outside of big cities; the Oklahoma City branch, 18 directors all chosen by banks outside the big cities; the Seattle branch, 10 directors, 3 chosen by the big city banks and 7 by the others; and the San Francisco branch, 10 directors, the big city banks and the others choosing 5 each.

It will be observed that, according to this calculation, the big city banks might control the New York City branch, but none of the others, the nearest approximation to control in any of the others being in the San Francisco branch in which they divide the vote equally with the other banks. The percentage of the directors which they might elect in the other branches varies from 0 in the cases of the Fort Worth, Salt Lake City, Helena, and Oklahoma City branches to 38 per cent in the Cincinnati branch, that for each branch being as follows: Boston, 30; New York, 72; Atlanta, 7; New Orleans, 15; Fort Worth, 0; Cincinnati, 38; Chicago, 25; St. Louis, 29; Minneapolis, 15; Denver, 11; Salt Lake City, 0; Helena, 0; Oklahoma City, 0; Seattle, 30; and San Francisco, 50.

On the basis of these statistics we may arrive at an estimate of the magnitude of the task the big banks would undertake if they should attempt to get control of the branches of the association.

In the Boston district, they would have to acquire 3 votes in order to control that branch; in that of Atlanta, 10; in that of

New Orleans, 8; in that of Fort Worth, 5; in that of Cincinnati, 2; in that of Chicago, 4; in that of St. Louis, 4; in that of Minneapolis, 13; in that of Denver, 6; in that of Salt Lake City, 3; in that of Helena, 3; in that of Oklahoma City, 5; in that of Seattle, 2; and in that of San Francisco, 1. If they should attempt to acquire these votes by the process of organizing national banks with the minimum capitalization of $25,000, they would have to create approximately 200 banks in the Boston district; 1,000 in the Atlanta district; 800 in the New Orleans district; 500 in the Fort Worth district; 225 in the Cincinnati district; 400 in the Chicago district; 600 in the St. Louis district; 1,400 in the Minneapolis district; 700 in the Denver district; 700 in the Oklahoma City district; 150 in the Salt Lake City district; 200 in the Helena district; 100 in the Seattle district; and 125 in the San Francisco district. Control of all the branches, therefore, would involve the creation of upwards of 7,000 banks at a cost of approximately $175,000,000. The control of a majority of the branches, however, and through them of the directorate of the central association could be obtained by the creation of approximately 1,400 banks at an expense of $21,000,000.

In these calculations many assumptions have been made, some of which will almost certainly not be realized, but without which no calculation would have been possible. Some of them are favorable to the control of the big city banks, others unfavorable. For example I have assumed that the Aldrich plan will be so modified as to open the doors of the association to state banks and trust companies, and that all banks will become members. I hope that the former assumption will be realized, but it is hardly possible that the latter can be, even approximately. The calculation, however, suggests the importance, in the interests of freedom from control by special interests, of making membership in the association attractive to all banks, since the larger the membership the more difficult and the less likely such control will be.

Another assumption is that all banks in cities of 100,000 population and above are subject to control by special interests. This assumption is certainly too favorable to such interests. There are certainly many cities in that group whose banks could not and

would not be so controlled, but, on the other hand, there are smaller cities, which are assumed to be independent of such control, which are not thus independent. The practice employed to a considerable extent of establishing chains of banks throughout the country gives such interests some influence even in country districts. All things considered, however, I believe that the assumption places vastly more power in the hands of special interests than they actually possess.

I have also assumed that the proportion between the capitalization of big city national banks and other banks holds for all banks and trust companies. I believe that this assumption errs on the side of assigning too much power to special interests. The capitalization of state banks in small towns and country districts probably bears a much larger proportion to their total capitalization than does that of national banks in such towns to their total capitalization. In the foregoing calculations, therefore, I have probably assigned to the big city banks too many votes on the basis of capitalization.

It must also be recognized that the statistics I have been obliged to use are very incomplete and in many cases inaccurate and I have doubtless made errors in calculation in the haste which has been unavoidable. Nevertheless I believe that, in a rough sort of way, the attempt to picture in imagination the system in actual operation has furnished a basis for fruitful discussion of the possible control of the association by special interests.

If I have even dimly foreshadowed the situation as it would actually exist if the Aldrich plan, with the modifications suggested, were put into operation, it must be admitted that "the interests" could probably command the funds needed to purchase control of all the branches, certainly of the directorate of the central association. There remains, however, the important question whether the expenditure of the requisite amount to accomplish these ends would be justified from the standpoint even of "the interests" themselves.

Two possible advantages suggest themselves as obtainable through control of the association: the securing of more liberal treatment than would otherwise be possible, and the power of

bringing pressure to bear on banks and the business men associated with them. Inasmuch as the services of the proposed association are to be confined almost exclusively to rediscounting, shipping currency, and holding reserves, and, inasmuch as it is to be equipped with the means of performing these services for all banks to the fullest extent necessary for the conduct of legitimate banking, it is difficult to see why any interest would need to obtain control of it in order to secure liberal treatment. The ordinary banker would have nothing to gain by discrimination against Wall Street or special interests that might desire the services of the association. Strict compliance with the conditions prescribed by law for rendering such services would be the only thing it would be in his interest to insist upon and special interests would gain in the long run rather than lose by such compliance. Certainly there is little likelihood that these interests would receive such treatment at the hands of the association as to render necessary or desirable the expenditure of millions of dollars in order to secure better accommodations.

If control of the association is coveted, therefore, it will probably be for the power it might give to force compliance with the schemes which "the interests" might have in hand. In other words, it is not so much the fear of being discriminated against as the power to discriminate against others that might stimulate the desire to get control of the association and justify the expenditure of millions for that purpose. It is claimed that Wall Street now possesses and exercises precisely this power and that she would not permit it to slip from her grasp if such an issue could be prevented by the expenditure of a few millions.

The extent to which the association could be used for sinister purposes of this kind would depend in part upon the amount of discretion in the matter of rejecting discounts left in the hands of the administrative officers, and in part upon the regulations prescribed by law pertaining to the relations between the central office and the branches and between the branches and the local associations. If the final decision regarding the acceptance or rejection of paper presented for discount is left to the officers of the central association or of the branches or of both, their power to discriminate against an individual institution or interest they might

wish to discipline cannot be questioned; but if the association is obliged to discount paper which fully complies with the conditions prescribed by law, it is difficult to see how discrimination could be practiced. On this matter of the discretionary power of the executive officers, the Aldrich plan is not perfectly definite, but the use of the word "may" instead of "shall" in the clauses descriptive of the kinds of paper admissible to discount seems to leave the final decision with them.

Assuming such discretionary power to lie in their hands, the question of the relation between the central office and the branches becomes important. If this power is to be exercised exclusively by the officers of the central association, then the control of that association alone would give any interest or group of interests all the power they might need; but if their power is shared with the officers of the branches and if the appointment of these officers is left to the branch directorates, then the control of all the branches as well as of the central association would be necessary to any interest that really wanted to accomplish large things.

In this matter of the discretionary power of the administrative officers a compromise worth considering is possible. In the interests of sound banking it seems essential that they should possess the power to reject paper presented to them for discount directly by the banks, but they might be *compelled* to discount paper which bears the signature of a local association. Such a regulation would throw the responsibility in the selection of paper upon the local associations who must bear the loss involved in a bad choice. There would be no danger in such a practice, and it would enormously increase the magnitude of the task which would confront any interest that might desire to get control. While, according to the calculation previously described, control of all the branches might be obtained for about $175,000,000, control of all or even of a majority of the local associations would cost a sum that might cause even a Wall Street magnate to pause.

So far we have been considering simply whether special interests would be likely to find it worth their while from a financial point of view to gain control of the association by the process of creating new banks. Another aspect of this question is worth considering.

Would the creation of 7,000 or even of 1,400 banks for this purpose be practicable? Would the public or the United States government or our states permit it? In the present and probably future state of public opinion on these matters how would the Comptroller of the Currency and the bank commissioners of our states be likely to act when confronted by applications of this kind? It is my understanding that in most, if not in all, cases they have discretionary power in these matters. How would they be likely to use it? Would it be possible for the interests so to conceal themselves and their designs that neither these officers nor the public would know what was going on?

However one may answer these questions, the fact remains that the people are afraid, and any plan that wins their confidence must be so specific and convincing on all matters pertaining to control that they can see precisely how it will work. Several amendments or supplements to the Aldrich plan seem to me, therefore, to be desirable. One should pertain to the organization of local associations and branches including the location of the authority that is to determine their boundaries, composition, and number. The determination of these matters in advance of putting the scheme into actual operation, is, of course, impossible, since previous to that time we cannot know how many and what banks will become members of the association; but it is possible to lay down rules for the guidance of those who are to determine these matters when the time comes and to determine in what hands this power shall lie.

Another amendment should fix the powers of the officers of the central association and the branches pertaining to the rejection of paper presented for discount either directly by the banks or through the local associations. Another should limit the voting power of banks the stock of which is owned in whole or in part by other institutions, and perhaps of directors who own stock in more than one institution.

Mr. Hill's proposition that all voting for directors should be on the basis of "one bank one vote" is also worthy of careful consideration. This principle may be defended, I think, on grounds which are independent of the question of control by special interests.

The Central Reserve Association is not designed to be attractive to its members on the score of the dividends it may earn for them. Its primary function is to be that of an instrument of service, a sort of mechanism to assist them in transacting in a more perfect and satisfactory manner their business as independent banks. Its officers, therefore, should be chosen with reference to their fairness, their ability to hold the scales of justice perfectly even, their unselfish devotion to the interests of all, as well as with reference to their ability as bankers. Does a larger capitalization give one bank wisdom or rights superior to that of another in the choice of men of that type? Would not the combined judgment of all the bankers of the country without reference to the magnitude of their assets be the best possible guaranty of a proper choice?

There still remains for consideration one aspect of the question of control. However carefully the machinery for the election of directors and officers may be devised and safeguarded, will not the strong masterful men who know precisely what they want and who understand every detail of the finances of the country, really determine the elections by their powers of persuasion and by their attention to the business, and are not those men usually allied with special interests whose power is feared? I know of no answer to this query that will satisfy all. It is, however, true, I believe, that bankers as well as other people are on guard against the machinations of "the interests"; and I have sufficient faith in democracy to believe that the rank and file of any great industry like that of banking, if given the power, are able to protect themselves against the sinister designs of the leaders of their craft.

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